KT&G CORPORATION

Separate Financial Statements

December 31, 2015 and 2014

(With Independent Auditors' Report Thereon)

Contents

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Independent Auditors' Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders
KT&G Corporation:

Report on the separate financial statements

We have audited the accompanying separate financial statements of KT&G Corporation (the "Company"), expressed in Korean won, which comprise the separate statement of financial position as of December 31, 2015, and the separate statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the separate financial statements

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with Korean International Financial Reporting Standards ("K-IFRS"), and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these separate financial statements based on our audit. We conducted our audit in accordance with Korean Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the separate financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the separate financial statements present fairly, in all material respects, the separate financial position of the Company as at December 31, 2015 and of its separate financial performance and its separate cash flows for the years then ended in accordance with K-IFRS.

Other matters

The accompanying separate statement of financial position of the Company as of December 31, 2014, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, were audited by other auditors, whose report thereon dated February 5, 2015, expressed an unqualified opinion.

The procedures and practices utilized in the Republic of Korea to audit such separate financial statements may differ from those generally accepted and applied in other countries.

The accompanying separate financial statements as of and for the year ended December 31, 2015 have been translated into United States dollars solely for the convenience of the reader and such translation does not comply with K-IFRS. We have audited the translation and, in our opinion, the separate financial statements expressed in Korean won have been translated into dollars on the basis set forth in note 5 to the separate financial statements.

KPMG Samjong Accounting Corp.

KPMG Samjong Accounting Corp.
Seoul, Korea
February 25, 2016

This report is effective as of February 25, 2016, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying separate financial statements and notes thereto. Accordingly, the readers of the audit report should understand that the above audit report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION
Separate Statements of Financial Position

As of December 31, 2015 and 2014

In millions of won and thousands of U.S. dollars	*Note*	2015 Korean won	2015 U.S. dollars (note 5)	2014 Korean won
Assets				
Property, plant and equipment	*6*	₩ 1,309,632	$ 1,117,433	₩ 1,279,660
Intangible assets	*7*	22,494	19,193	19,636
Investment property	*8,17*	136,801	116,724	140,141
Investments in associates	*9*	46,230	39,445	60,225
Investments in subsidiaries	*10*	1,124,446	959,425	1,081,840
Available-for-sale financial assets	*11,31*	340,149	290,230	303,438
Long-term deposits in MSA Escrow Fund	*12,32,34*	403,966	344,681	301,808
Long-term prepaid expenses		6,706	5,723	4,160
Long-term trade and other receivables	*13,31,32*	78,600	67,065	120,702
Total non-current assets		3,469,024	2,959,919	3,311,610
Inventories	*14*	889,035	758,562	910,438
Current available-for-sale financial assets	*11,32*	-	-	1,000
Other financial assets	*15,32,33*	1,091,976	931,720	640,000
Prepaid tobacco excise and other taxes		447,771	382,057	260,773
Trade and other receivables	*13,31,32*	1,074,862	917,118	824,948
Advance payments		26,489	22,601	20,233
Prepaid expenses		4,152	3,543	3,922
Cash and cash equivalents	*15,32,33*	444,376	379,160	321,562
Total current assets		3,978,661	3,394,761	2,982,876
Not-current assets held for sale	*16*	1,542	1,316	426
Total assets		₩ 7,449,227	$ 6,355,996	₩ 6,294,912

See accompanying notes to the separate financial statements.

KT&G CORPORATION
Separate Statements of Financial Position, Continued

As of December 31, 2015 and 2014

In millions of won and thousands of U.S. dollars	*Note*	December 31 2015 Korean won	December 31 2015 U.S. dollars (note 5)	December 31 2014 Korean won
Equity				
Ordinary shares	*1,18*	₩ 954,959	$ 814,812	₩ 954,959
Other capital surplus	*18*	3,582	3,056	3,582
Treasury shares	*19*	(337,062)	(287,595)	(339,059)
Gain on reissuance of treasury shares	*19*	494,648	422,055	492,032
Reserves	*20*	3,784,467	3,229,067	3,493,758
Retained earnings	*21*	995,886	849,733	736,460
Total equity		5,896,480	5,031,128	5,341,732
Liabilities				
Long-term trade and other payables	*17,23,31,32*	8,147	6,951	28,310
Long-term advance receipts		491	419	2,344
Net defined benefit liability	*25*	42,174	35,985	67,260
Deferred income tax liabilities		72,179	61,586	69,196
Total non-current liabilities		122,991	104,941	167,110
Short-term borrowings	*24,32,33*	5,031	4,292	5,552
Trade and other payables	*23,31,32*	433,824	370,157	347,240
Advance receipts		26,024	22,205	26,245
Income tax payable		199,767	170,450	157,545
Tobacco excise and other taxes payable		765,110	652,823	249,488
Total current liabilities		1,429,756	1,219,927	786,070
Total liabilities		1,552,747	1,324,868	953,180
Total equity and liabilities		₩ 7,449,227	$ 6,355,996	₩ 6,294,912

See accompanying notes to the separate financial statements.

KT&G CORPORATION
Separate Statements of Comprehensive Income

For the years ended December 31, 2015 and 2014

In millions of won and thousands of U.S. dollars, except earnings per share	*Note*	2015 Korean won	2015 U.S. dollars (note 5)	2014 Korean won
Sales:	*30,33*			
Manufacture of tobacco		₩ 2,607,650	$ 2,224,957	₩ 2,499,986
Real estate		142,847	121,883	160,342
Exports of leaf tobacco and others		71,175	60,729	82,233
		2,821,672	2,407,569	2,742,561
Cost of sales:	*25,30*			
Manufacture of tobacco		(813,639)	(694,231)	(914,356)
Real estate		(84,915)	(72,453)	(96,076)
Exports of leaf tobacco and others		(48,091)	(41,033)	(53,362)
		(946,645)	(807,717)	(1,063,794)
Gross profit		1,875,027	1,599,852	1,678,767
Selling, general and administrative expenses	*25,30*	(637,709)	(544,120)	(624,212)
Operating profit		1,237,318	1,055,732	1,054,555
Other income	*26,30*	104,453	89,124	71,897
Other expenses	*26,30*	(103,360)	(88,191)	(157,307)
Finance income	*27,31*	81,917	69,895	77,139
Finance costs	*27,31*	(888)	(758)	(830)
Net finance income	*27*	81,029	69,137	76,309
Profit before income tax		1,319,440	1,125,802	1,045,454
Income tax expense	*28*	(331,516)	(282,863)	(298,400)
Profit for the year		₩ 987,924	$ 842,939	₩ 747,054
Other comprehensive income (loss):				
Items that will not be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax		₩ 7,962	$ 6,794	₩ (13,016)
Items that are or may be reclassified subsequently to profit or loss				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		(17,695)	(15,099)	(21,863)
Other comprehensive loss for the year, net of tax		(9,733)	(8,305)	(34,879)
Total comprehensive income for the year		₩ 978,191	$ 834,634	₩ 712,175
Earnings per share in won and U.S. dollars:				
Basic and diluted	*29*	₩ 7,843	$ 6.69	₩ 5,934

See accompanying notes to the separate financial statements.

KT&G CORPORATION
Separate Statements of Changes in Equity

For the year ended December 31, 2015

In millions of won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2015	₩	954,959	3,582	(339,059)	492,032	3,493,758	736,460	5,341,732
Total comprehensive income for the year:								
Profit for the year		-	-	-	-	-	987,924	987,924
Other comprehensive income (loss):								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	7,962	7,962
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(17,695)	-	(17,695)
Total other comprehensive loss		-	-	-	-	(17,695)	7,962	(9,733)
Total comprehensive income for the year		-	-	-	-	(17,695)	995,886	978,191
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(428,056)	(428,056)
In-kind donation of treasury shares		-	-	1,997	2,616	-	-	4,613
Transfer from reserve for research and human resource development		-	-	-	-	(12,522)	12,522	-
Transfer to unconditional reserve		-	-	-	-	320,926	(320,926)	-
Total transactions with owners		-	-	1,997	2,616	308,404	(736,460)	(423,443)
Balance at December 31, 2015	₩	954,959	3,582	(337,062)	494,648	3,784,467	995,886	5,896,480

See accompanying notes to the separate financial statements.

KT&G CORPORATION
Separate Statements of Changes in Equity, Continued

For the year ended December 31, 2015

In thousands of U.S. dollars (note 5)		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2015	$	814,812	3,056	(289,299)	419,823	2,981,022	628,379	4,557,793
Total comprehensive income for the year:								
Profit for the year		-	-	-	-	-	842,939	842,939
Other comprehensive income (loss):								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	6,794	6,794
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(15,099)	-	(15,099)
Total other comprehensive loss		-	-	-	-	(15,099)	6,794	(8,305)
Total comprehensive income for the year		-	-	-	-	(15,099)	849,733	834,634
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(365,235)	(365,235)
In-kind donation of treasury shares		-	-	1,704	2,232	-	-	3,936
Transfer from reserve for research and human resource development		-	-	-	-	(10,684)	10,684	-
Transfer to unconditional reserve		-	-	-	-	273,828	(273,828)	-
Total transactions with owners		-	-	1,704	2,232	263,144	(628,379)	(361,299)
Balance at December 31, 2015	$	814,812	3,056	(287,595)	422,055	3,229,067	849,733	5,031,128

See accompanying notes to the separate financial statements.

KT&G CORPORATION
Separate Statements of Changes in Equity, Continued

For the year ended December 31, 2014

In millions of won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2014	₩	954,959	3,582	(339,059)	492,032	3,411,099	509,820	5,032,433
Total comprehensive income for the year:								
Profit for the year		-	-	-	-	-	747,054	747,054
Other comprehensive loss:								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(13,016)	(13,016)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(21,863)	-	(21,863)
Total other comprehensive loss		-	-	-	-	(21,863)	(13,016)	(34,879)
Total comprehensive income for the year		-	-	-	-	(21,863)	734,038	712,175
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(402,876)	(402,876)
Transfer from reserve for research and human resource development		-	-	-	-	(47,478)	47,478	-
Transfer to unconditional reserve		-	-	-	-	152,000	(152,000)	-
Total transactions with owners		-	-	-	-	104,522	(507,398)	(402,876)
Balance at December 31, 2014	₩	954,959	3,582	(339,059)	492,032	3,493,758	736,460	5,341,732

See accompanying notes to the separate financial statements.

KT&G CORPORATION
Separate Statements of Cash Flows

For the years ended December 31, 2015 and 2014

In millions of won and thousands of U.S. dollars	*Note*	2015 Korean won	2015 U.S. dollars (note 5)	2014 Korean won
Cash flows from operating activities				
Cash generated from operations	*35*	₩ 1,600,888	$ 1,365,945	₩ 1,002,253
Income tax paid		(284,038)	(242,353)	(250,630)
Net cash provided by operating activities		1,316,850	1,123,592	751,623
Cash flows from investing activities				
Interest received		29,374	25,063	30,139
Investment income received from long-term deposits in MSA Escrow Fund		1,486	1,268	1,346
Dividends received		20,217	17,250	20,525
Proceeds from sale of property, plant and equipment		9,563	8,159	8,787
Proceeds from sale of intangible assets		1,593	1,359	1
Proceeds from sale of non-current assets held for sale		4,260	3,635	55
Proceeds from investments in associates		13,625	11,625	-
Proceeds from investments in subsidiaries		-	-	85
Proceeds from sale of available-for-sale financial assets		233	199	10,010
Collection of loans		11,220	9,573	13,629
Withdrawal of guarantee deposits		18,171	15,505	19,842
Acquisition of property, plant and equipment		(138,416)	(118,102)	(235,843)
Acquisition of intangible assets		(3,752)	(3,201)	(1,164)
Acquisition of investment property		(64)	(55)	(223)
Acquisition of investments in subsidiaries		(77,207)	(65,877)	(8,101)
Acquisition of available-for-sale financial assets		(34,200)	(29,181)	(51,992)
Increase in loans		(59,935)	(51,139)	(9,946)
Payments of guarantee deposits		(16,485)	(14,065)	(20,723)
Payments of long-term deposits in MSA Escrow Fund		(78,492)	(66,973)	(70,094)
Decrease (increase) in other financial assets		(440,000)	(375,427)	20,000
Acquisition of redeemable convertible preference shares		(26,000)	(22,184)	-
Net cash used in investing activities		(764,809)	(652,568)	(273,667)
Cash flows from financing activities				
Dividends paid		(428,056)	(365,235)	(402,876)
Increase in deposits received		3,411	2,910	3,465
Decrease in deposits received		(4,605)	(3,929)	(2,820)
Net cash used in financing activities		(429,250)	(366,254)	(402,231)
Effect of exchange rate fluctuation on cash held		23	19	(1)
Net increase in cash and cash equivalents		122,814	104,789	75,724
Cash and cash equivalents at January 1		321,562	274,371	245,838
Cash and cash equivalents at December 31		₩ 444,376	$ 379,160	₩ 321,562

See accompanying notes to the separate financial statements.

For the years ended December 31, 2015 and 2014

1. Organization and Description of Business

KT&G Corporation (the "Company"), which is engaged in manufacturing and selling tobaccos, was established on April 1, 1987 as Korea Monopoly Corporation, a wholly-owned enterprise of the Korean government, pursuant to the Korea Monopoly Corporation Act, in order to secure financing and to promote and develop, through efficient management, the monopoly business of red ginseng and tobacco. On April 1, 1989, the Company changed its name to Korea Tobacco and Ginseng Corporation pursuant to the Korea Tobacco and Ginseng Corporation Act. Also, pursuant to the Act on Management Reform and Privatization of Public Enterprises, proclaimed on August 28, 1997 and enforced on October 1, 1997, the Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Company became an entity existing and operating under the Commercial Act of Korea. The Korean government sold 28,650,000 shares of the Company to the public during 1999 and the Company listed its shares on the Korea Exchange (formerly, the Korea Stock Exchange) on October 8, 1999. On December 27, 2002, the Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

As of December 31, 2015, the Company has three manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 123 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located in 71, Beotkkot-gil, Daedeok-gu, Daejeon.

Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the shareholders approved a plan to separate the Company into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Company's contribution of the assets and liabilities in the red ginseng business segment into a wholly-owned subsidiary, Korea Ginseng Corporation.

On October 17, 2002 and October 31, 2001, the Company listed 35,816,658 and 45,400,000 Global Depositary Receipts ("GDR") (each GDR representing the right to receive one-half share of an ordinary share of the Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Company's GDR was changed from the BdL market to the Euro MTF in the Luxembourg Stock Exchange.

The ownership of the Company's issued ordinary shares as of December 31, 2015 is held as follows:

Shareholder	Number of shares	Percentage of ownership
National Pension Service	11,098,167	8.08%
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	2,603,918	1.90%
Treasury shares	11,326,605	8.25%
Others	102,753,322	74.84%
	137,292,497	100.00%

2. Basis of Preparation

(a) Statement of Compliance

The separate financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"), as prescribed in *the Act on External Audits of Corporations* in the Republic of Korea.

These financial statements are separate financial statements prepared in accordance with K-IFRS No.1027 *Separate Financial Statements* presented by a parent, an investor in an associate or a venture in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

The separate financial statements were authorized for issue by the Board of Directors on January 21, 2016, which will be submitted for approval to the shareholders' meeting to be held on March 18, 2016.

(b) Basis of Measurement

The separate financial statements have been prepared on the historical cost basis, except for the following material items in the separate statements of financial position:

- Derivative financial instruments measured at fair value
- Available-for-sale financial assets measured at fair value
- Liabilities for defined benefit plans recognized at the net of the total present value of defined benefit obligations less the fair value of plan assets

(c) Functional and Presentation Currency

These separate financial statements are presented in Korean won, which is the Company's functional currency and the currency of the primary economic environment in which the Company operates.

(d) Use of Estimates and Judgments

The preparation of the separate financial statements in conformity with K-IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following note:

- Note 4 – classification of financial instruments;

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

- Note 10 – impairment test: key assumptions underlying recoverable amounts;
- Note 25 – measurement of defined benefit obligations: key actuarial assumptions; and
- Notes 34 – recognition and measurement of contingencies: key assumptions about likelihood and magnitude of an outflow of resources.

2. Basis of Preparation, Continued

(e) Measurement of Fair Values

A number of the Company's accounting policies and disclosures require the measurement of fair values, for both financial and non-financial assets and liabilities. The Company has an established control framework with respect to the measurement of fair values. This includes a valuation team that has overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values, and reports directly to the CFO.

The valuation team regularly reviews significant unobservable inputs and valuation adjustments. If third party information, such as broker quotes or pricing services, is used to measure fair values, then the valuation team assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of K-IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Significant valuation issues are reported to the Company's Audit Committee.

When measuring the fair value of an asset or a liability, the Company uses market observable data as far as possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability fall into different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. The Company recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

Further information about the assumptions made in measuring fair values is included in following notes:

- Note 8 – investment property
- Note 32 – financial instruments

3. Changes in Accounting Policies

The accounting policies applied in these separate financial statements are the same as those applied in the Company's separate financial statements as of and for the year ended December 31, 2014, except for the adoption of amendments to K-IFRS 1019 *Employee Benefits*.

Amendments to K-IFRS 1019 introduced a practical expedient to accounting for defined benefit plan, when employees or third parties pay contributions if certain criteria are met. According to the amendments, the entity is permitted to recognize those contributions as a reduction of the service cost in the period in which the related service is rendered, instead of forecast future contributions from employees or third parties and attribute them to periods or service as negative benefits.

The Company retrospectively applied the amendments in accordance with the transitional requirements of K-IFRS 1019. The changes do not have a significant impact on the Company's separate financial statements.

4. Significant Accounting Policies

The significant accounting policies applied by the Company in preparation of its separate financial statements are included below. The accounting policies set out below have been applied consistently to all periods presented in these separate financial statements except for the changes in accounting policies as explained in note 3.

(a) Subsidiaries and Associates in the Separate Financial Statements

These separate financial statements are prepared and presented in accordance with K-IFRS No.1027. The Company applied the cost method to investments in subsidiaries, associates and joint ventures in accordance with K-IFRS No. 1027. Dividends from a subsidiaries, associates and joint ventures are recognized in profit or loss when the right to receive the dividend is established.

(b) Property, Plant and Equipment

All property, plant and equipment are stated at historical cost less depreciation and accumulated impairment loss. Historical cost includes expenditures directly attribute to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over estimated useful lives that appropriately reflect the pattern in which the asset's future economic benefits are expected to be consumed.

The estimated useful lives of the Company's assets are as follows:

	Useful lives (years)		Useful lives (years)
Buildings	10 ~ 60	Vehicles	4
Structures	10 ~ 40	Tools	4
Machinery	10 ~ 12	Furniture and fixtures	4

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in other income and expense in the statement of comprehensive income.

4. Significant Accounting Policies, Continued

(c) Borrowing Costs

The Company capitalizes borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Other borrowing costs are recognized in expense as incurred. A qualifying asset is an asset that requires a substantial period of time to get ready for its intended use or sale. Financial assets and inventories that are manufactured or otherwise produced over a short period of time are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

To the extent that the Company borrows funds specifically for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. The Company immediately recognizes other borrowing costs as an expense. To the extent that the Company borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Company that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that the Company capitalizes during a period does not exceed the amount of borrowing costs incurred during that period.

(d) Government Grants

Government grants are not recognized unless there is reasonable assurance that the Company will comply with the grant's conditions and that the grant will be received. Government grants which are intended to compensate the Company for expenses incurred are recognized as other income in profit or loss over the periods in which the Company recognizes the related costs as expenses.

(e) Intangible Assets

Intangible assets are measured initially at cost and, subsequently, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, facility usage rights and intangible assets under development. Intangible assets are amortized on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The residual value of intangible assets is assumed to be zero. However, as there are no foreseeable limits to the periods over which some of industrial property rights and facility usage rights are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.

The estimated useful lives are as follows:

	Useful lives (years)
Industrial property rights	10 ~ 20 or indefinite
Facility usage rights	indefinite

Amortization periods and amortization methods for intangible assets with finite useful lives are reviewed at the end of each reporting period. The useful lives of intangible assets that are not being amortized are reviewed at the end of each reporting period to determine whether events and circumstances continue to support indefinite useful life assessment for those assets. The change is accounted for as a change in an accounting estimate.

4. Significant Accounting Policies, Continued

(f) Investment Property

Property held for the purpose of earning rentals or benefiting from capital appreciation is classified as investment property. Investment property is initially measured at its cost. Transaction costs are included in the initial measurement. Subsequently, investment property is carried at depreciated cost less any accumulated impairment losses.

Subsequent costs are recognized in the carrying amount of investment property at cost or, if appropriate, as separate items if it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Investment property except for land, are depreciated on a straight-line basis over 10 ~ 60 years as estimated useful lives.

Depreciation methods, useful lives and residual values are reviewed at the end of each reporting date and adjusted, if appropriate. The change is accounted for as a change in an accounting estimate.

(g) Non-current Assets Held for Sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. In order to be classified as held for sale, the asset (or disposal group) must be available for immediate sale in its present condition and its sale must be highly probable. The assets or disposal group that are classified as non-current assets held for sale are measured at the lower of their carrying amount and fair value less cost to sell.

The Company recognizes an impairment loss for any initial or subsequent write-down of an asset (or disposal group) to fair value less costs to sell, and a gain for any subsequent increase in fair value less costs to sell, up to the cumulative impairment loss previously recognized in accordance with K-IFRS No. 1036 *Impairment of Assets*.

A non-current asset that is classified as held for sale or part of a disposal group classified as held for sale is not depreciated (or amortized).

(h) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

The cost of inventories is determined by the weighted-average method for finished goods, by-products, work-in-progress and tobacco leaf in raw materials, by the moving-average method for raw materials and supplies; and by the specific identification method for all other inventories.

4. Significant Accounting Policies, Continued

(h) Inventories, Continued

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories and recognized as an expense in the period in which the reversal occurs.

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩310,043 million and ₩272,649 million, respectively, as of December 31, 2015 and 2014.

(i) Impairment of Non-financial Assets

The carrying amounts of the Company's non-financial assets, other than inventories, deferred tax assets, assets arising from employee benefits and non-current assets held for sale, are reviewed at the end of the reporting period to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, irrespective of whether there is any indication of impairment, are tested for impairment annually by comparing their recoverable amount to their carrying amount.

The Company estimates the recoverable amount of an individual asset. If it is impossible to measure the individual recoverable amount of an asset, then the Company estimates the recoverable amount of cash-generating unit ("CGU"). A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. The value in use is estimated by applying a pre-tax discount rate that reflect current market assessments of the time value of money and the risks specific to the asset or CGU for which estimated future cash flows have not been adjusted, to the estimated future cash flows expected to be generated by the asset or CGU.

An impairment loss is recognized if the carrying amount of an asset or a CGU exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

(j) Non-derivative Financial Assets

The Company recognizes and measures non-derivative financial assets by the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. The Company recognizes financial assets in the statement of financial position when the Company becomes a party to the contractual provisions of the instrument.

Upon initial recognition, non-derivative financial assets are measured at their fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the asset's acquisition or issuance.

4. Significant Accounting Policies, Continued

(j) Non-derivative Financial Assets, Continued

(i) Financial assets at fair value through profit or loss

A financial asset is classified as financial assets are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition, transaction costs are recognized in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

(ii) Held-to-maturity investments

A non-derivative financial asset with a fixed or determinable payment and fixed maturity, for which the Company has the positive intention and ability to hold to maturity, are classified as held-to-maturity investments. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

(iii) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for loans and receivables of which the effect of discounting is immaterial.

(iv) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value, which changes in fair value, net of any tax effect, recorded in other comprehensive income in equity. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are measured at cost.

(v) De-recognition of financial assets

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

If the Company retains substantially all the risks and rewards of ownership of the transferred financial assets, the Company continues to recognize the transferred financial assets and recognizes financial liabilities for the consideration received.

4. Significant Accounting Policies, Continued

(j) Non-derivative Financial Assets, Continued

(vi) Offsetting between financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position only when the Company currently has a legally enforceable right to offset the recognized amounts, and there is the intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

(k) Derivative Financial Instruments

Derivatives are initially recognized at fair value. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are recognized immediately in profit or loss.

Embedded derivatives are separated from the host contract and accounted for separately only if the following criteria have been met:

- the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative and
- the hybrid instrument is not measured at fair value with changes in fair value recognized in profit or loss.

Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

(l) Impairment of Financial Assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. However, losses expected as a result of future events, regardless of likelihood, are not recognized.

If financial assets have objective evidence that they are impaired, impairment losses should be measured and recognized.

(i) Financial assets measured at amortized cost

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of its estimated future cash flows discounted at the asset's original effective interest rate. If it is not practicable to obtain the instrument's estimated future cash flows, impairment losses would be measured by using prices from any observable current market transactions. The Company can recognize impairment losses directly or establish a provision to cover impairment losses. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed either directly or by adjusting an allowance account.

4. Significant Accounting Policies, Continued

(l) Impairment of Financial Assets, Continued

(ii) Financial assets carried at cost

If there is objective evidence that an impairment loss has occurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

(iii) Available-for-sale financial assets

When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from other comprehensive income to profit or loss as a reclassification adjustment even though the financial asset has not been derecognized. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as available-for-sale are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss. For an investment in an equity security, objective evidence of impairment includes a significant or prolonged decline in its fair value below its cost. The Company considers a decline of 20% to be significant and a period of nine months to be prolonged.

(m) Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Company in the management of its short-term commitments. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares when it has a short maturity with a specified redemption date.

(n) Non-derivative Financial Liabilities

The Company classifies non-derivative financial liabilities into financial liabilities at fair value through profit or loss, financial guarantee liabilities and other financial liabilities in accordance with the substance of the contractual arrangement and the definitions of financial liabilities. The Company recognizes financial liabilities in the statement of financial position when the Company becomes a party to the contractual provisions of the financial liability.

(i) Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading or designated as such upon initial recognition. Subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. Upon initial recognition, transaction costs that are directly attributable to the acquisition are recognized in profit or loss as incurred.

4. Significant Accounting Policies, Continued

(n) Non-derivative Financial Liabilities, Continued

(ii) Financial guarantee liabilities

Financial guarantee liability is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified term of a debt instrument. Upon initial recognition, financial guarantee liabilities are measured at their fair value plus, transaction costs that are directly attributable to the acquisition or issue of the financial guarantee liability.

After initial recognition, an issuer of such a contract measures it at the higher of the amount determined in accordance with K-IFRS No. 1037 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized less, when appropriate, cumulative amortisation recognized in accordance with K-IFRS No. 1018 *Revenue.*

(iii) Other financial liabilities

Non-derivative financial liabilities other than financial liabilities at fair value through profit or loss or financial guarantee liabilities are classified as other financial liabilities. At the date of initial recognition, other financial liabilities are measured at fair value minus transaction costs that are directly attributable to the acquisition. Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest method.

The Company derecognizes a financial liability from the statement of financial position when it is extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

(o) Employee Benefits

(i) Short-term employee benefits

Short-term employee benefits are employee benefits that are due to be settled within 12 months after the end of the period in which the employees render the related service. When an employee has rendered service to the Company during an accounting period, the Company recognizes the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

(ii) Retirement benefits: defined contribution plans

When an employee has rendered service to the Company during a period, the Company recognizes the contribution payable to a defined contribution plan in exchange for that service as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, the Company recognizes that excess as an asset (prepaid expense) to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

4. Significant Accounting Policies, Continued

(o) Employee Benefits, Continued

(iii) Retirement benefits: defined benefit plans

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Company, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. The Company determines the net interest expense (income) on the net defined benefit liability (asset) for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. The Company recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

(iv) Termination benefits

Termination benefits are expensed at the earlier of when the Company can no longer withdraw the offer of those benefits and when the Company recognizes costs for a restructuring. If benefits are not expected to be settled wholly within 12 months of the end of the reporting period, then they are discounted.

(p) Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Where the effect of the time value of money is material, provisions are determined at the present value of the expected future cash flows.

Where some or all of the expenditures required to settle a provision are expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset.

Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimates. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed.

4. Significant Accounting Policies, Continued

(q) Equity Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

When the Company repurchases its share capital, the amount of the consideration paid is recognized as a deduction from equity and classified as treasury shares. The profits or losses from the purchase, disposal, reissue, or retirement of treasury shares are not recognized as current profit or loss. If the Company acquires and retains treasury shares, the consideration paid or received is directly recognized in equity.

(r) Revenue Recognition

The Company's revenue categories consist of goods sold, services and other income.

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the years ended December 31, 2015 and 2014 were ₩5,179,692 million and ₩3,536,343 million, respectively.

Revenue from the construction of real estate includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completions is assessed by reference to surveys of work performed. Meanwhile, profits from an apartment house for self-installment sales is recognized on percentage-of-completion method according to Q&A of Korea Accounting Institute, called 2011-I-KQA. This accounting standard is effective upon Korean Corporation Financial Reporting Standards of Laws on External Audit of Corporation (Article 13, Section 1, Paragraph 1)

Revenue from rendering of services is recognized by reference to the stage of completion of the transaction at the end of the reporting period when the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company, the stage of completion of the transaction at the end of the reporting period can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

Rental income from investment property, net of lease incentives granted, is recognized in profit or loss on a straight-line basis over the term of the lease.

4. Significant Accounting Policies, Continued

(s) Finance Income and Finance Costs

Finance income comprises interest income on funds invested (including available-for-sale financial assets), dividend income and interest income on long-term deposits in MSA Escrow Fund. Interest income is recognized as it accrues in profit or loss, using the effective interest method. Dividend income is recognized in profit or loss on the date that the Company's right to receive payment is established.

Finance costs is interest expense on unwinding of the discount on trade and other payables which is recognized in profit or loss using the effective interest method.

(t) Income Taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

(i) Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years. The taxable profit is different from the accounting profit for the year since the taxable profit is calculated excluding the temporary differences, which will be taxable or deductible in determining taxable profit (tax loss) of future periods, and non-taxable or non-deductible items from the accounting profit.

(ii) Deferred tax

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. The Company recognizes a deferred tax asset for all deductible temporary differences to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset only if there is a legally enforceable right to offset the related current tax liabilities and assets, and they relate to income taxes levied by the same tax authority and they intend to settle current tax liabilities and assets on a net basis

4. Significant Accounting Policies, Continued

(u) Foreign Currencies

Transactions in foreign currencies are translated to the respective functional currencies of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency using the reporting date's exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognized in other comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(v) Earnings per Share

The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares.

(w) Operating Segment

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's chief executive officer to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Operating segment disclosures are included in the consolidated financial statements in accordance with K-IFRS No. 1108 *Operating Segments*.

5. Basis of Translating Financial Statements

The separate financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,172.00 to $1, the basic exchange rate on December 31, 2015 posted by Seoul Money Brokerage Services, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into U.S. dollars at this or any other rate.

6. Property, Plant and Equipment

(a) Details of property, plant and equipment as of December 31, 2015 and 2014 are summarized as follows:

				2015			2014
In millions of won		Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩	467,590	-	467,590	457,890	-	457,890
Buildings		696,569	(311,151)	385,418	690,661	(286,158)	404,503
Structures		44,962	(29,061)	15,901	44,422	(27,272)	17,150
Machinery		991,848	(775,864)	215,984	972,679	(735,831)	236,848
Vehicles		2,211	(1,855)	356	2,304	(2,033)	271
Tools		37,753	(32,199)	5,554	36,425	(31,978)	4,447
Furniture and fixtures		169,422	(135,913)	33,509	158,793	(123,346)	35,447
Others		1,366	-	1,366	1,312	-	1,312
Construction-in-progress		183,954	-	183,954	121,792	-	121,792
	₩	2,595,675	(1,286,043)	1,309,632	2,486,278	(1,206,618)	1,279,660

(b) Changes in property, plant and equipment for the year ended December 31, 2015 were as follows:

In millions of won		January 1 2015	Acquisition	Disposal	Depreciation	Transfer of construction-in-progress	Other changes	December 31 2015
Land	₩	457,890	7,158	(773)	-	5,293	(1,978)	467,590
Buildings		404,503	1,238	(398)	(26,812)	9,124	(2,237)	385,418
Structures		17,150	836	(41)	(2,159)	174	(59)	15,901
Machinery		236,848	4,649	(411)	(50,716)	25,614	-	215,984
Vehicles		271	263	(14)	(193)	29	-	356
Tools		4,447	3,005	(144)	(2,101)	347	-	5,554
Furniture and fixtures		35,447	15,276	(6)	(17,236)	28	-	33,509
Others		1,312	54	-	-	-	-	1,366
Construction-in-progress		121,792	102,771	-	-	(40,609)	-	183,954
	₩	1,279,660	135,250	(1,787)	(99,217)	-	(4,274)	1,309,632

For the year ended December 31, 2015, land and buildings with a carrying amount of ₩2,732 million were transferred to investment property and land, buildings and structures with a carrying amount of ₩1,542 million were transferred to non-current assets held for sale.

6. Property, Plant and Equipment, Continued

(c) Changes in property, plant and equipment for the year ended December 31, 2014 were as follows:

In millions of won		January 1 2014	Acquisition	Disposal	Depreciation	Transfer of construction-in-progress	Other changes	December 31 2014
Land	₩	410,763	1,611	(652)	-	75,028	(28,860)	457,890
Buildings		400,314	1,552	(1,182)	(26,351)	30,093	77	404,503
Structures		16,973	1,946	(21)	(2,105)	357	-	17,150
Machinery		234,926	7,410	(60)	(50,666)	51,140	(5,902)	236,848
Vehicles		362	109	-	(200)	-	-	271
Tools		3,135	2,000	(85)	(1,611)	1,008	-	4,447
Furniture and fixtures		34,524	14,220	(5)	(17,151)	3,859	-	35,447
Others		1,162	150	-	-	-	-	1,312
Construction-in-progress		80,604	207,079	(58)	-	(161,485)	(4,348)	121,792
	₩	1,182,763	236,077	(2,063)	(98,084)	-	(39,033)	1,279,660

For the year ended December 31, 2014, land and construction-in-progress with a carrying amount of ₩32,682 million were transferred to inventories and machinery with a carrying amount of ₩5,902 million was contributed to KGC Yebon Corporation as in-kind capital contribution.

7. Intangible Assets

(a) Details of intangible assets as of December 31, 2015 and 2014 are summarized as follows:

		2015			2014		
In millions of won		Cost	Accumulated amortization	Carrying amount	Cost	Accumulated amortization	Carrying amount
Industrial property rights	₩	6,997	(5,535)	1,462	7,163	(5,596)	1,567
Facility usage rights		19,180	(1,708)	17,472	17,701	(2,658)	15,043
Intangible assets under development		3,560	-	3,560	3,026	-	3,026
	₩	29,737	(7,243)	22,494	27,890	(8,254)	19,636

(b) Changes in intangible assets for the year ended December 31, 2015 were as follows:

In millions of won		January 1 2015	Acquisition	Disposal	Amortization	December 31 2015
Industrial property rights	₩	1,567	23	(104)	(24)	1,462
Facility usage rights		15,043	3,195	(766)	-	17,472
Intangible assets under development		3,026	534	-	-	3,560
	₩	19,636	3,752	(870)	(24)	22,494

7. Intangible Assets, Continued

(c) Changes in intangible assets for the year ended December 31, 2014 were as follows:

In millions of won		January 1 2014	Acquisition	Disposal	Impairment	Amortization	December 31 2014
Industrial property rights	₩	1,625	-	-	-	(58)	1,567
Facility usage rights		17,357	347	(3)	(2,658)	-	15,043
Intangible assets under development		2,209	817	-	-	-	3,026
	₩	21,191	1,164	(3)	(2,658)	(58)	19,636

(d) Expenditures not capitalized for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Cost of sales	₩	296	250
Selling, general and administrative expenses		12,273	14,042
	₩	12,569	14,292

8. Investment Property

(a) Details of investment property as of December 31, 2015 and 2014 are summarized as follows:

		2015			2014		
In millions of won		Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩	23,066	-	23,066	22,236	-	22,236
Buildings		172,757	(59,022)	113,735	170,124	(52,219)	117,905
	₩	195,823	(59,022)	136,801	192,360	(52,219)	140,141

(b) Changes in investment property for the years ended December 31, 2015 and 2014 were as follows:

		2015			2014		
In millions of won		Land	Buildings	Total	Land	Buildings	Total
Beginning balance	₩	22,236	117,905	140,141	22,246	123,788	146,034
Acquisition		-	64	64	-	222	222
Depreciation		-	(6,136)	(6,136)	-	(6,028)	(6,028)
Transfer from (to) property, plant and equipment		830	1,902	2,732	(10)	(77)	(87)
Ending balance	₩	23,066	113,735	136,801	22,236	117,905	140,141

8. Investment Property, Continued

(c) The amounts recognized in profit or loss from investment property for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Rental income	₩	33,992	33,069
Direct operating expense		(6,136)	(6,028)
	₩	27,856	27,041

(d) The carrying amount and the fair value of investment property as of December 31, 2015 and 2014 were as follows:

		2015		2014	
In millions of won		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	406,600	23,066	281,106	22,236
Buildings		171,979	113,735	180,272	117,905
	₩	578,579	136,801	461,378	140,141

The fair value of investment property was determined based on the yield capitalization method by external, independent valuers. The fair value measurement for all of the investment properties has been categorized as a level 3 fair value based on the inputs to the valuation techniques used.

9. Investments in Associates

Investments in associates as of December 31, 2015 and 2014 are summarized as follows:

In millions of won			2015		2014	
Company	Location	Principal operation	Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	20.24%	₩ 1,830	25.34%	₩ 1,830
JR CR-REIT IV Co., Ltd.	Korea	Renting real estate	-	-	49.02%	13,995
KVG REIT 1 Co., Ltd.	Korea	Renting real estate	29.67%	7,300	29.67%	7,300
KOCREF REIT 17 Co., Ltd.	Korea	Renting real estate	22.06%	7,000	22.06%	7,000
JR REIT V Co., Ltd.	Korea	Renting real estate	34.63%	5,600	34.63%	5,600
JR REIT VIII Co., Ltd.	Korea	Renting real estate	21.74%	10,000	21.74%	10,000
LSK Global Pharma Services Co., Ltd.	Korea	Researching and developing medicine	23.15%	-	23.15%	-
JR REIT X Co., Ltd.	Korea	Renting real estate	28.79%	9,500	28.79%	9,500
JR REIT XIII Co., Ltd.	Korea	Renting real estate	27.03%	5,000	27.03%	5,000
				₩ 46,230		₩ 60,225

In 2015, the Company's ownership in Lite Pharm Tech, Inc. has decreased to 20.24% due to their paid-in capital increase.

In 2015, the Company recognized ₩370 million of loss on disposal of investments in associates as JR CR-REIT IV Co., Ltd. was liquidated.

For the years ended December 31, 2015 and 2014

10. Investments in Subsidiaries

Investments in subsidiaries as of December 31, 2015 and 2014 are summarized as follows:

In millions of won

			2015		2014	
Company	Location	Principal operation	Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00%	₩ 672,048	100.00%	₩ 672,048
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceutical	53.00%	66,355	53.00%	66,355
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00%	15,698	100.00%	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99%	30,049	99.99%	30,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobaccos	99.99%	2,891	99.90%	535
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99%	-	99.99%	-
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00%	110,297	100.00%	110,297
KGC Life & Gin Co., Ltd.	Korea	Selling ginseng door-to-door	100.00%	44,100	100.00%	44,100
Global Trading, Inc.	USA	Selling tobaccos	100.00%	4,913	100.00%	4,913
Somang Cosmetics Co., Ltd.(*)	Korea	Manufacturing and selling cosmetics	97.73%	70,676	60.00%	20,921
Renzoluc Pte., Ltd.(*)	Singapore	Manufacturing and selling tobaccos	100.00%	-	100.00%	22,156
KT&G Life Sciences Corporation(*)	Korea	Researching and developing medicine	73.94%	14,287	73.94%	15,332
KGC Yebon Corporation	Korea	Manufacturing and selling medical herbs	100.00%	49,828	100.00%	49,828
K-Q HongKong I, Limited(*)	HongKong	Manufacturing and selling ginseng	100.00%	17,761	100.00%	17,761
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.99%	-	99.99%	11,400
K&I HK Co., Ltd.	HongKong	Selling cosmetics	100.00%	11	100.00%	11
K&I China Co., Ltd.	China	Selling cosmetics	100.00%	5,532	100.00%	436
SangSang Stay, Inc.	Korea	Hotel	100.00%	20,000	-	-
				₩1,124,446		₩1,081,840

(*) The Company's percentage of ownership, shown above, excludes preferred shares. As of December 31, 2015, the Company's percentage of ownership would be 97.76%, 68.91%, 59.48% and 50.00%, respectively, if preferred shares are included.

10. Investments in Subsidiaries, Continued

For the year ended December 31, 2015, the Company acquired additional shares of Somang Cosmetics Co., Ltd. for ₩49,775 million, increasing its ownership from 60.00% to 97.73%.

For the year ended December 31, 2015, the Company made an additional investment of ₩2,356 million and ₩5,096 million in Korean Tobacos do Brasil Ltda. and K&I China Co., Ltd, respectively.

For the year ended December 31, 2015, the Company established SangSang Stay, Inc.

For the year ended December 31, 2015, the Company recognized ₩34,601 million of impairment losses on investments in Renzoluc Pte., Ltd., KT&G Life Sciences Corporation and PT KT&G Indonesia since the carrying amounts exceeded their recoverable amounts.

For the year ended December 31, 2014, the Company made an additional investment of ₩7,654 million in PT KT&G Indonesia and established K&I HK Co., Ltd. and K&I China Co., Ltd.

For the year ended December 31, 2014, the Company acquired ₩73,025 million of additional interest in Korea Ginseng Corporation through an in-kind capital contribution of its interest in Jilin Hanzheng Ginseng Co., Ltd. and other available-for-sale financial assets with a carrying amount of ₩47,675 million and ₩25,350 million, respectively.

For the year ended December 31, 2014, the Company acquired ₩5,902 million of interest in KGC Yebon through an in-kind capital contribution.

For the year ended December 31, 2014, the Company recognized ₩5 million of loss on disposal of investments in subsidiaries as Yebon Nongwon Agriculture Co., Ltd. was liquidated.

For the year ended December 31, 2014, the Company recognized ₩123,900 million of impairment losses on investments in KT&G Tutun Mamulleri Sanayi ve Ticaret A.S., Somang Cosmetics Co., Ltd., Renzoluc Pte, Ltd. and KT&G Life Sciences Corporation since the carrying amounts exceeded their recoverable amounts.

11. Available-for-sale Financial Assets

(a) Changes in available-for-sale financial assets for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	304,438	296,391
Acquisitions		63,190	51,992
Net changes in fair value		1,744	(28,844)
Reclassification to investments in subsidiaries		-	(24,930)
Net gain reclassified from equity		-	19,829
Disposals		(29,223)	(10,000)
Ending balance	₩	340,149	304,438
Statement of financial position:			
Current	₩	-	1,000
Non-current		340,149	303,438
	₩	340,149	304,438

In 2015, the Company acquired ₩28,990 million of ordinary shares of U&I Corporation by exercising conversion options embedded in their convertible bonds and convertible preference shares. The Company recognized ₩24,990 million of difference between the fair value of ordinary shares acquired and the carrying amount of bonds and preference shares converted as gain on sale of available-for-sale financial assets for the year ended December 31, 2015.

(b) Available-for-sale financial assets as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
Available-for-sale debt instruments:			
Corporate bonds	₩	1,500	2,500
Available-for-sale equity instruments:			
Listed			
– Oscotech, Inc.		3,696	1,030
– Shinhan Financial Group Co., Ltd.		158,530	178,171
– Rexahn Pharmaceuticals, Inc.		2,696	4,917
– U&I Corporation		22,564	-
		187,486	184,118
Unlisted		151,163	117,820
Total available-for-sale equity instruments		338,649	301,938
Total available-for-sale financial assets	₩	340,149	304,438

The fair value of listed available-for-sale equity instruments is principally based on quoted prices in an active market.

As of December 31, 2015 and 2014, ₩37,555 million and ₩29,594 million of available-for-sale financial assets that do not have a market price in an active market and whose fair value cannot be reliably measured or is similar to their carrying amount are measured at cost, respectively.

12. Long-term Deposits in MSA Escrow Fund

Long-term deposits in MSA Escrow Fund as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
MMF	₩	43,309	19,269
Treasury note		360,657	282,539
	₩	403,966	301,808

As discussed in note 34 to the separate financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. For the years ended December 31, 2015 and 2014, ₩78,492 million and ₩70,094 million were paid into long-term deposits in MSA Escrow Fund, respectively.

Long-term deposits in MSA Escrow Fund are invested in demand deposits of financial institutions or government and public bonds. Interest income on long-term deposits in MSA Escrow Fund for the years ended December 31, 2015 and 2014 are ₩1,287 million and ₩877 million, respectively.

13. Trade and Other Receivables

(a) Trade and other receivables as of December 31, 2015 and 2014 are summarized as follows:

			2015		2014
In millions of won		Current	Non-current	Current	Non-current
Loans to employees	₩	15,767	51,976	7,811	19,885
Loans		69,813	8,204	8,612	61,711
Other receivables		142,130	1,551	72,964	1,697
Guarantee deposits		19,070	16,869	-	37,409
Accrued income		8,912	-	7,808	-
Trade receivables		819,170	-	727,753	-
	₩	1,074,862	78,600	824,948	120,702

(b) Trade and other receivables as of December 31, 2015 and 2014 have been reported in the separate statements of financial position net of allowances as follows:

			2015		2014
In millions of won		Current	Non-current	Current	Non-current
Gross trade and other receivables	₩	1,121,048	78,600	869,457	131,276
Allowance:					
Loans		(12,447)	-	(1,099)	(10,574)
Other receivables		(7,570)	-	(7,673)	-
Accrued income		(2,264)	-	(2,126)	-
Trade receivables		(23,905)	-	(33,611)	-
		(46,186)	-	(44,509)	(10,574)
Net trade and other receivables	₩	1,074,862	78,600	824,948	120,702

13. Trade and Other Receivables, Continued

(c) Changes in the allowance account for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	55,083	65,357
Impairment loss		2,569	510
Reversal of impairment loss		(11,466)	(10,784)
Ending balance	₩	46,186	55,083

Impairment loss (reversal of impairment loss) on trade and other receivables is included as part of selling, general and administrative expenses and other expense (income) in the separate statements of comprehensive income.

(d) The aging schedule of trade and other receivables which were past due but not impaired as of December 31, 2015 and 2014 is as follows:

In millions of won		2015	2014
Within 1 month	₩	48,107	46,952
Between 1 and 2 months		39,921	35,915
Beyond 2 months		245,788	210,237
	₩	333,816	293,104

There is no significant concentration of credit risk with respect to trade and other receivables since trade and other receivables, excluding export trade receivables, are widely dispersed amongst a number of customers. The Company holds pledged assets and guarantees in respect of some of the past due debtor balances.

(e) Details of trade and other receivables that are measured at amortized cost as of December 31, 2015 and 2014 were as follows:

	2015				2014			
In millions of won	Effective interest rate		Current	Non-current	Effective interest rate		Current	Non-current
Loans to employees	1.89~5.68%	₩	15,767	51,976	3.00~5.68%	₩	7,811	19,885
Other receivables	-		-	-	3.79%		8,300	-
Guarantee deposits	1.89~5.68%		19,070	16,869	3.00~5.68%		-	37,409
		₩	34,837	68,845		₩	16,111	57,294

14. Inventories

(a) Inventories as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
Finished goods, net of loss on the write-down of inventories	₩	72,394	83,387
Work-in-progress		15,294	7,645
Raw materials		685,101	699,260
Supplies		25,959	25,319
By-products		5,515	7,138
Buildings under construction		3,618	1,185
Sites for lotting-out construction		25,815	31,180
Goods-in-transit		55,339	55,324
	₩	889,035	910,438

(b) The amount of inventories recognized as an expense for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Cost of sales:			
Reversal of write-down of inventories	₩	(183)	(1,911)
Loss on retirement of inventories		825	3,367
Other expense:			
Loss on retirement of inventories		844	588
	₩	1,486	2,044

15. Cash and Cash Equivalents and Other Financial Assets

(a) Cash and cash equivalents as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
Cash on hand	₩	2,623	883
Demand deposits		71,753	80,679
Short-term investment assets		370,000	240,000
	₩	444,376	321,562

(b) Other financial assets as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
Time deposits	₩	100,000	10,000
Money trust		950,000	600,000
Certificates of deposit		30,000	30,000
Derivative financial instruments		11,976	-
	₩	1,091,976	640,000

During the year ended December 31, 2015, the Company acquired redeemable convertible preference shares of Somang Cosmetics Co., Ltd. and recognized embedded derivatives as other financial assets separately from the host contract. The fair value of derivative financial instruments was determined based on the DCF and option pricing model by external, independent valuers.

16. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	426	3
Transfer from property, plant and equipment		1,542	426
Disposal		(426)	(3)
Ending balance	₩	1,542	426

17. Pledged Assets

(a) Investment property pledged as collateral as of December 31, 2015 was as follows:

In millions of won

Asset		Carrying amount	Type		Received amount	Collateralized amount	Leaseholder
Investment property	₩	70,769	Leasehold deposits received	₩	8,975	9,225	Metlife Insurance Korea Co., Ltd. and others

(b) Investment property pledged as collateral as of December 31, 2014 was as follows:

In millions of won

Asset		Carrying amount	Type		Received amount	Collateralized amount	Leaseholder
Investment property	₩	71,677	Leasehold deposits received	₩	7,901	8,683	Metlife Insurance Korea Co., Ltd. and others

18. Share Capital and Other Capital Surplus

(a) Details of share capital as of December 31, 2015 and 2014 were as follows:

		2015	2014
Number of ordinary shares:			
Authorized		800,000,000	800,000,000
Issued		137,292,497	137,292,497
Outstanding		125,965,892	125,898,800
Par value in won	₩	5,000	5,000

The Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of December 31, 2015, the Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the years ended December 31, 2015 and 2014 were as follows:

	2015			2014		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning balance	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,393,697)	125,898,800
In-kind donation of treasury shares	-	67,092	67,092	-	-	-
Ending balance	137,292,497	(11,326,605)	125,965,892	137,292,497	(11,393,697)	125,898,800

(c) There was no change in other capital surplus for the years ended December 31, 2015 and 2014.

For the years ended December 31, 2015 and 2014

19. Treasury Shares

(a) Changes in the treasury shares for the years ended December 31, 2015 and 2014 were as follows:

In millions of won, except number of shares	2015 Number of shares	2015 Carrying amount	2014 Number of shares	2014 Carrying amount
Beginning balance	11,393,697	₩ 339,059	11,393,697	₩ 339,059
In-kind donation of treasury shares	(67,092)	(1,997)	-	-
Ending balance	11,326,605	₩ 337,062	11,393,697	₩ 339,059

(b) Changes in gain on reissuance of treasury shares for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	492,032	492,032
In-kind donation of treasury shares, net of tax		2,616	-
Ending balance	₩	494,648	492,032

20. Reserves

(a) Details of reserves as of December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Available-for-sale financial assets - net change in fair value	₩	(45,128)	(27,434)
Legal reserve		602,937	602,937
Voluntary reserve		3,226,658	2,918,255
	₩	3,784,467	3,493,758

20. Reserves, Continued

(b) Available-for-sale financial assets - net change in fair value as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
Available-for-sale financial assets - net change in fair value before tax	₩	(59,536)	(36,192)
Tax effect		14,408	8,758
	₩	(45,128)	(27,434)

(c) Legal Reserve

The Korean Commercial Act requires the Company to appropriate a legal reserve in an amount equal to at least 10% of cash dividends for each accounting period until the reserve equals 50% of stated capital. The legal reserve may be used to reduce a deficit or may be transferred to ordinary shares in connection with a free issue of shares.

(d) Details of voluntary reserve as of December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Reserve for business rationalization	₩	12,851	12,851
Reserve for research and human resource development		30,000	42,523
Reserve for business expansion		698,881	698,881
Unconditional reserve		2,484,926	2,164,000
	₩	3,226,658	2,918,255

Reserve for business rationalization
Until December 10, 2002 under *the Restriction of Special Taxation Act*, investment tax credits were allowed for certain investments. The Company was, however, required to appropriate from retained earnings, the amount of tax benefits received, and transfer such amount into a reserve for business rationalization.

Effective December 11, 2002, the Company was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.

Reserve for research and human resource development
According to *the Restriction of Special Taxation Act*, certain taxable deductions are required to be transferred from retained earnings to reserve for research and human resource development. This reserve may be used for each purpose and their remaining amounts could be reclassified as a voluntary reserve.

Reserve for business expansion and other reserves
Reserves without specific purposes are restored to retained earnings by the Company. Those reserves can be used for other purposes afterwards upon a resolution at a general meeting of shareholders.

21. Retained Earnings

(a) Changes in retained earnings for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	736,460	509,820
Dividends		(428,056)	(402,876)
Transfer from reserve for research and human resource development		12,522	47,478
Transfer to unconditional reserve		(320,926)	(152,000)
Profit for the year		987,924	747,054
Remeasurements of net defied benefit liability, net of tax		7,962	(13,016)
Ending balance	₩	995,886	736,460

(b) Statements of appropriation of retained earnings for the years ended December 31, 2015 and 2014 are as follows:

Date of appropriation for 2015: March 18, 2016
Date of appropriation for 2014: February 27, 2015

In millions of won		2015	2014
Unappropriated retained earnings:			
Beginning balance	₩	-	2,422
Profit for the year		987,924	747,054
Remeasurements of net defined benefit liability, net of tax		7,962	(13,016)
		995,886	736,460
Transfer from voluntary reserves		10,000	12,522
Unappropriated retained earnings available for appropriation		1,005,886	748,982
Appropriation of retained earnings:			
Dividends		(428,284)	(428,056)
Unconditional reserve		(577,602)	(320,926)
		(1,005,886)	(748,982)
Unappropriated retained earnings to be carried over to subsequent year	₩	-	-

22. Dividends

The following dividends were declared and paid by the Company for the years ended December 31, 2015 and 2014 are as follows:

		2015	2014
Dividends in millions of won	₩	428,056	402,876
Dividends per share in won		3,400	3,200
Dividend rate as a percentage of par value		68.00%	64.00%

Dividends of ₩428,284 million (₩3,400 per share) will be proposed at the shareholders' meeting to be held on March 18, 2016. The dividends have not been recognized as liabilities.

23. Trade and Other Payables

Trade and other payables as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015 Current	2015 Non-current	2014 Current	2014 Non-current
Leasehold deposits received	₩	19,404	8,147	-	28,310
Trade payables		65,154	-	66,448	-
Withholdings		4,749	-	4,031	-
Withholdings value added tax		184,587	-	132,173	-
Accrued expenses		125,699	-	110,155	-
Other payables		34,231	-	34,433	-
	₩	433,824	8,147	347,240	28,310

24. Short-term Borrowings

Short-term borrowings as of December 31, 2015 and 2014 are summarized as follows:

In millions of won	Annual interest rate		2015	2014
Customer credit contracts:				
Nonghyup Bank	6.64%	₩	4,099	4,536
KEB Hana Card Co., Ltd.	3M CD rate+2.5%		932	1,016
		₩	5,031	5,552

The Company has entered into a customer credit contract with the Nonghyup Bank and KEB Hana Card Co., Ltd. The financial institutions pay trade receivables for customers and the Company has provided guarantees to the financial institutions for customers.

25. Retirement Benefits Plan

(a) The components of retirement benefits for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Defined benefit plans:			
Current service cost	₩	28,383	27,282
Interest cost		1,749	2,229
Expected return on plan assets		-	
Past service cost and loss on settlement		-	165
		30,132	29,676
Defined contribution plans:			
Contributions recognized as expense		4,185	2,860
	₩	34,317	32,536

The Company recognized termination benefits amounting to ₩12,741 million and ₩272 million as an expense for the years ended December 31, 2015 and 2014, respectively.

25. Retirement Benefits Plan, Continued

(b) Changes in net defined benefit liability for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	67,260	60,273
Service cost		28,383	27,447
Net interest on net defined benefit liability		1,749	2,229
Remeasurements of net defined benefit liability before tax		(10,504)	17,171
Retirement benefits paid		(4,714)	(5,360)
Contributions to plan assets		(40,000)	(34,500)
Ending balance	₩	42,174	67,260
Statement of financial position:			
Present value of defined benefit obligations	₩	247,774	258,236
Fair value of plan assets		(205,600)	(190,976)
Net defined benefit liability	₩	42,174	67,260

(c) Changes in defined benefit obligations for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	258,236	227,258
Current service costs		28,383	27,282
Past service costs		-	165
Interest expense		6,590	8,083
Actuarial losses (gains) before tax		(10,952)	16,100
Retirement benefits paid		(34,483)	(20,652)
Ending balance	₩	247,774	258,236

(d) Changes in plan assets for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	190,976	166,986
Interest income		4,841	5,854
Return on plan assets, excluding interest income on plan assets		(448)	(1,071)
Retirement benefits paid		(29,769)	(15,293)
Contributions to plan assets		40,000	34,500
Ending balance	₩	205,600	190,976

Actual returns on plan assets were ₩4,393 million and ₩4,783 million for the years ended December 31, 2015 and 2014, respectively.

25. Retirement Benefits Plan, Continued

(e) Details of remeasurements of net defined benefit liability in other comprehensive income for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Actuarial gains (losses) before tax:			
Demographic assumptions	₩	9,558	-
Financial assumptions		(8,305)	(3,172)
Experience adjustments		9,699	(12,928)
		10,952	(16,100)
Return on plan assets, excluding interest income on plan assets		(448)	(1,071)
Remeasurements of net defined benefit liabilities before tax		10,504	(17,171)
Tax effect		(2,542)	4,155
Remeasurements of net defined benefit liabilities, net of tax	₩	7,962	(13,016)

(f) The components of plan assets as of December 31, 2015 and 2014 are as follows:

In millions of won		2015	2014
Deposits, cash and cash equivalents	₩	22,226	26,146
Others		183,374	164,830
	₩	205,600	190,976

(g) The principal actuarial assumptions as of December 31, 2015 and 2014 are as follows:

	2015	2014
Discount rate	2.20%	2.60%
Salary increase rate	4.00%	4.00%

For the purpose of calculating present value of the defined benefit obligations, the Company used the discount rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds consistent with the currency and estimated term of the defined benefit obligations.

As of December 31, 2015 and 2014, the weighted average duration of the defined benefit obligations was 8.09 years and 11.99 years, respectively.

(h) The effects of changes in each significant actuarial assumptions on defined benefit obligations as of December 31, 2015 would be as follows:

In millions of won	1% point increase	1% point decrease
Discount rate	(19,947)	22,903
Salary increase rate	22,332	(19,870)

For the years ended December 31, 2015 and 2014

26. Result from Operating Activities

(a) Details of expenses classified by nature for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Changes in inventories	₩	21,403	26,672
Raw materials and consumables purchased		735,999	777,874
Salaries		340,536	341,276
Retirement and termination benefits		47,058	32,808
Depreciation		105,353	104,113
Amortization		24	58
Employee welfare		62,005	40,600
Advertising		120,304	132,801
Commissions		103,012	104,172
Other expenses		48,660	127,632
	₩	1,584,354	1,688,006

(b) Details of selling, general and administrative expenses for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Salaries	₩	232,370	229,515
Retirement and termination benefits		34,277	21,743
Employee welfare		43,819	29,198
Travel		4,736	4,212
Communications		3,407	3,589
Utilities		8,598	8,259
Taxes and dues		16,028	15,290
Supplies		1,945	1,867
Rent		12,918	13,578
Depreciation		32,682	32,369
Amortization		24	58
Repairs and maintenance		3,228	6,005
Vehicles		4,800	6,351
Insurance		284	326
Commissions		78,174	79,736
Freight and custody		28,401	27,415
Conferences		2,743	2,969
Advertising		120,152	132,647
Training		4,244	3,757
Prizes and rewards		2,312	2,070
Normal research and development		12,273	14,042
Reversal of impairment loss on trade receivables		(9,706)	(10,784)
	₩	637,709	624,212

27. Other Income and Expenses

(a) Details of other income for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Foreign currency transaction gain	₩	27,188	14,739
Foreign currency translation gain		39,761	31,247
Reversal of impairment loss on other receivables		1,760	-
Gain on sale of property, plant and equipment		12,421	8,064
Gain on sale of intangible assets		723	-
Others		22,600	17,847
	₩	104,453	71,897

(b) Details of other expenses for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Foreign currency transaction loss	₩	9,622	10,718
Foreign currency translation loss		3,317	3,185
Impairment loss on other receivables		2,569	510
Loss on disposal of investments in associates		370	-
Loss on disposal of investments in subsidiaries		-	5
Impairment loss on investments in subsidiaries		34,601	123,900
Loss on sale of property, plant and equipment		513	1,290
Loss on sale of intangible assets		-	2
Impairment loss on intangible assets		-	2,658
Donations		43,665	6,787
Others		8,703	8,252
	₩	103,360	157,307

28. Net Finance Income

(a) Details of net finance income for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Finance income:			
Interest income	₩	33,330	35,605
Dividend income		21,014	20,525
Interest income on long-term deposits in MSA Escrow Fund		1,287	877
Gain on sale of available-for-sale financial assets		25,183	20,132
Gain on valuation of derivatives		1,103	-
		81,917	77,139
Finance costs:			
Interest costs		(793)	(830)
Impairment loss on available-for-sale financial assets		(95)	-
		(888)	(830)
Net finance income	₩	81,029	76,309

(b) Details of interest income for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Deposits	₩	25,821	26,815
Available-for-sale financial assets		40	50
Trade and other receivables		7,469	8,740
	₩	33,330	35,605

(c) Details of interest expenses for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Trade and other payables	₩	793	830

29. Income Tax

(a) The components of income tax expense for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Current income tax expense	₩	326,329	273,279
Adjustments recognized in the period for current tax of prior periods		(69)	(1,387)
Changes in temporary difference		2,983	15,373
		329,243	287,265
Less: tax expense recognized outside profit or loss		2,273	11,135
	₩	331,516	298,400

(b) Current tax and deferred tax that were recognized outside profit or loss for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Current tax:			
Gain on reissuance of treasury shares	₩	835	-
Deferred tax:			
Net changes in fair value of available-for-sale financial assets		(5,650)	(6,980)
Remeasurements of the net defined benefit liabilities		2,542	(4,155)
		(3,108)	(11,135)
Tax expense recognized outside profit or loss	₩	(2,273)	(11,135)

Income tax related to gain on reissuance of treasury shares was recognized directly in equity and income tax related to net changes in fair value of available-for-sale financial assets and remeasurements of the net defined benefit liabilities were recognized in other comprehensive income.

(c) Reconciliation of income tax expense based on statutory tax rate to actual income tax expense for the years ended December 31, 2015 and 2014 are as follows:

In millions of won		2015	2014
Profit before income tax	₩	1,319,440	1,045,454
Normal tax rate		24.20%	24.20%
Income taxes at statutory tax rate		319,278	252,538
Adjustment:			
Non-taxable income		(314)	(1,664)
Non-deductible expenses		5,447	3,578
Changes in unrecognized deferred tax		8,373	44,403
Tax credits and deduction		(544)	(855)
Adjustments recognized in the period for current tax of prior periods		(69)	(1,387)
Other		(655)	1,787
Income tax expense	₩	331,516	298,400
Effective tax rate		25.10%	24.40%

29. Income Tax, Continued

(d) Changes in deferred income tax assets (liabilities) for the years ended December 31, 2015 and 2014 are as follows:

(i) For the year ended December 31, 2015

In millions of won		January 1 2015	Profit or loss	Other comprehensive income (loss)	December 31 2015
Accumulated depreciation	₩	7,117	459	-	7,576
Allowance		11,324	(2,613)	-	8,711
Available-for-sale financial assets		14,600	(6,024)	5,650	14,226
Accrued expenses		23,254	3,072	-	26,326
Defined benefit liability		9,191	(1,945)	(2,542)	4,704
Treasury Shares		(8,808)	52	-	(8,756)
Investments in subsidiaries		(106,837)	-	-	(106,837)
Advanced depreciation provision		(14,493)	-	-	(14,493)
Reserve		(7,260)	2,420	-	(4,840)
Other		2,716	(1,512)	-	1,204
	₩	(69,196)	(6,091)	3,108	(72,179)

(ii) For the year ended December 31, 2014

In millions of won		January 1 2014	Profit or loss	Other comprehensive income	December 31 2014
Accumulated depreciation	₩	8,248	(1,131)	-	7,117
Allowance		13,970	(2,646)	-	11,324
Available-for-sale financial assets		16,525	(8,905)	6,980	14,600
Accrued expenses		21,526	1,728	-	23,254
Defined benefit liability		6,061	(1,025)	4,155	9,191
Treasury Shares		(8,808)	-	-	(8,808)
Investments in subsidiaries		(89,976)	(16,861)	-	(106,837)
Advanced depreciation provision		(14,493)	-	-	(14,493)
Reserve		(10,290)	3,030	-	(7,260)
Other		3,414	(698)	-	2,716
	₩	(53,823)	(26,508)	11,135	(69,196)

29. Income Tax, Continued

(e) As of December 31, 2015 and 2014, deferred tax liability of ₩163,818 million and ₩129,217 million for temporary differences related to investments in subsidiaries and associates was not recognized, respectively, because the Company controls the timing of reversal of the temporary differences and management is satisfied that they will not reverse in the foreseeable future.

30. Earnings per Share

Basic and diluted earnings per share for the years ended December 31, 2015 and 2014 were as follows:

		2015	2014
Profit for the year in millions of won	₩	987,924	747,054
Weighted-average number of ordinary shares outstanding		125,961,848	125,898,800
Basic and diluted earnings per share in won	₩	7,843	5,934

The weighted-average number of ordinary shares outstanding is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor.

31. Transactions and Balances with Related Companies

(a) Details of parent and subsidiary relationships as of December 31, 2015 and 2014 were as follows:

			Percentage of ownership					
			2015			2014		
Subsidiary	Location	Immediate parent company	Parent	Sub-sidiary	Total	Parent	Sub-sidiary	Total
Korea Ginseng Corporation	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
Yungjin Pharm. Ind. Co., Ltd.	Korea	KT&G Corporation	53.00%	-	53.00%	53.00%	-	53.00%
Tae-a Industry Co., Ltd.	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	KT&G Corporation	99.99%	-	99.99%	99.99%	-	99.99%
Korea Tabacos do Brasil Ltda.	Brazil	KT&G Corporation	99.99%	-	99.99%	99.90%	-	99.90%
KT&G Pars	Iran	KT&G Corporation	99.99%	-	99.99%	99.99%	-	99.99%
KT&G Rus L.L.C.	Russia	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KGC Life & Gin Co., Ltd.	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
Global Trading, Inc.	USA	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
Somang Cosmetics Co., Ltd.(*1)	Korea	KT&G Corporation	97.73%	-	97.73%	60.00%	-	60.00%
Renzoluc Pte., Ltd.(*1)	Singapore	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Life Sciences Corporation(*1)	Korea	KT&G Corporation	73.94%	-	73.94%	73.94%	-	73.94%
KGC Yebon Corporation	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
K-Q HongKong I, Limited(*1)	HongKong	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
PT KT&G Indonesia	Indonesia	KT&G Corporation	99.99%	-	99.99%	99.99%	-	99.99%
K&I HK Co., Ltd.(*2)	HongKong	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
K&I China Co., Ltd.(*2)	China	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
SangSang Stay, Inc.(*3)	Korea	KT&G Corporation	100.00%	-	100.00%	-	-	-
Jilin Hanzheng Ginseng Co., Ltd.	China	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Korean Red Ginseng Corp., Inc.	USA	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Korea Ginseng Corporation Japan	Japan	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
PT CKJ INDONESIA	Indonesia	Korea Ginseng Corporation	-	99.88%	99.88%	-	99.88%	99.88%
PT Trisakti Purwosari Makmur	Indonesia	Renzoluc Pte., Ltd.	-	60.17%	60.17%	-	60.17%	60.17%
PT Mandiri Maha mulia	Indonesia	Renzoluc Pte., Ltd.	-	66.47%	66.47%	-	66.47%	66.47%
PT Sentosa Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24%	99.24%	-	99.24%	99.24%
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00%	100.00%	-	100.00%	100.00%

(*1) The percentage of ownership, shown above, excludes preferred shares. As of December 31, 2015, the Company's percentage of ownership would be 97.76%, 68.91%, 59.48% and 50.00%, respectively, if preferred shares are included.

(*2) The Company established K&I HK Co., Ltd. and K&I China Co., Ltd. in 2014.

(*3) The Company established SangSang Stay, Inc. in 2015.

31. Transactions and Balances with Related Companies, Continued

(b) Significant transactions which occurred in the normal course of business with related companies for the years ended December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015 Sales and other income	2015 Purchase and other expenses	2014 Sales and other income	2014 Purchase and other expenses
Korea Ginseng Corporation	₩	8,674	1,706	8,872	1,846
Yungjin Pharm. Ind. Co., Ltd.		330	28	363	40
Tae-a Industry Co., Ltd.		17	13,727	15	14,987
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		8,275	22	9,687	164
KT&G Pars		1,132	-	3,301	-
KT&G Rus L.L.C.		25,173	22	31,490	-
KGC Life & Gin Co., Ltd.		819	503	1,076	649
Global Trading, Inc.		106,723	-	66,588	-
Somang Cosmetics Co., Ltd.		138	131	177	155
Renzoluc Pte., Ltd.		3,699	-	4,007	-
KT&G Life Sciences Corporation		30	-	68	-
KGC Yebon Corporation		538	136	253	16
PT KT&G Indonesia		1,588	-	491	-
K&I China Co., Ltd.		-	226	-	-
Korea Ginseng (China) Corp.		-	-	-	233
PT Trisakti Purwosari Makmur		153	-	149	-
PT Mandiri Maha mulia		3,390	-	4,807	-
SangSang Stay, Inc.		45	-	-	-
	₩	160,724	16,501	131,344	18,090

(c) Account balances with related companies as of December 31, 2015 and 2014 were as follows:

In millions of won		2015 Receivables	2015 Payables	2014 Receivables	2014 Payables
Korea Ginseng Corporation	₩	37	2,044	764	1,795
Yungjin Pharm. Ind. Co., Ltd.		11	413	60	413
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		44,388	-	38,559	-
Korea Tabacos do Brasil Ltda.		99	-	94	-
KT&G Pars(*)		42,868	-	41,827	-
KT&G Rus L.L.C.(*)		38,425	-	27,701	-
KGC Life & Gin Co., Ltd.		-	245	109	165
Global Trading, Inc.		12,071	-	509	-
Somang Cosmetics Co., Ltd.		28,144	28	12	29
Renzoluc Pte., Ltd.		47,884	-	48,327	-
KT&G Life Sciences Corporation		-	1	5	814
PT KT&G Indonesia		29,112	-	18,580	-
PT Trisakti Purwosari Makmur		156	-	156	-
PT Mandiri Maha mulia		3,698	-	4,167	-
	₩	246,893	2,731	180,870	3,216

(*) Above receivables are the gross amounts before ₩20,198 million and ₩19,668 million of allowance for doubtful accounts.

31. Transactions and Balances with Related Companies, Continued

(d) Details of financial transactions with related parties for the years ended December 31, 2015 and 2014 were as follows:

				2015			2014
			Loans	Capital		Loans	Capital
In millions of won		Increase	Collection	Increase	Increase	Collection	Increase
Korea Ginseng Corporation	₩	-	-	-	-	-	73,025
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		-	1,099	-	-	-	-
Korea Tabacos do Brasil Ltda.		-	-	2,356	-	-	-
Global Trading, Inc.		-	-	-	-	2,035	-
Somang Cosmetics Co., Ltd.		-	-	49,755	-	-	-
Renzoluc Pte., Ltd.		969	-	-	-	-	-
KGC Yebon Corporation		-	-	-	-	-	5,902
PT KT&G Indonesia		7,748	-	-	9,946	-	7,654
K&I HK Co.,Ltd.		-	-	-	-	-	11
K&I China Co.,Ltd.		-	-	5,096	-	-	436
SangSang Stay, Inc.		-	-	20,000	-	-	-

During the year ended December 31, 2015, the Company acquired 94,079 shares of redeemable convertible preference shares of Somang Cosmetics Co., Ltd. for ₩26,000 million from KOFC QCP IBKC Frontier Champ 2010-2 Private Equity Fund.

(e) Details of key management personnel compensation for the years ended December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
Short-term employee benefits	₩	15,456	15,909
Retirement benefits		1,476	1,936
	₩	16,932	17,845

32. Risk Management and Fair Value of Financial Instruments

(a) Overview

The Company has exposure to the following risks from its use of financial instruments:

- Market risk
- Credit risk
- Liquidity risk

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk including quantitative disclosures.

(b) Risk Management Framework

The purpose of managing financial risks is to identify the potential risk factors that may affect the Company's financial performance, and minimize, eliminate and avoid it to the extent that is acceptable. One of the principal responsibilities of the treasury department is to manage the financial risks arising from the Company's underlying operations. The treasury department monitors and manages the financial risk arising from the Company's underlying operations in accordance with the risk management policies and procedures authorized by the board of directors. Also, the treasury department provides an internal report analyzing the nature and exposure level of financial risks to Risk Management Committee of the Company. The Risk Management Committee prepares the overall strategy for financial risk management, and evaluates the effectiveness of the financial risk management strategy. In addition, the Company's audit committee consistently observes the compliance of the risk management policy and procedure, and reviews the risk exposure limit of the Company. The Company applied the same financial risk management strategy that was applied in the previous period.

(c) Management of Financial Risks

(i) Market risk

Market risk is the risk that changes in market prices – such as foreign exchange rates, interest rates and equity prices – will affect the Company's income or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

32. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

Currency risk
The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates arising from the export and import of tobacco. The Company's management has measured the currency risk internally and regularly, and has entered into foreign currency forward contracts to hedge foreign currency risk, if necessary.

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of December 31, 2015 and 2014 were as follows:

		2015		2014	
In millions of won		Assets	Liabilities	Assets	Liabilities
USD	₩	918,070	44,431	785,423	44,293
IDR		48,190	-	48,327	6,785
EUR		30,375	1,504	28,988	-
Others		2,177	-	2,087	-
	₩	998,812	45,935	864,825	51,078

As of December 31, 2015 and 2014, the effects of a 10% weakening or strengthening of functional currency against foreign currencies on profit before tax were as follows:

		2015		2014	
In millions of won		10% weakening	10% strengthening	10% weakening	10% strengthening
Increase (decrease) in profit before tax	₩	95,288	(95,288)	81,375	(81,375)

Equity price risk
The Company has exposure to equity price risk, which arises from listed available-for-sale equity instruments. The Company's management has monitored the proportion of equity instruments in its investment portfolio based on market indices. Material investments within the portfolio are managed on an individual basis, and all buy and sell decisions are approved by the Company's management.

As of December 31, 2015 and 2014, the effects of a 5% fluctuation in the price index of stocks on comprehensive income before tax were as follows:

		2015		2014	
In millions of won		5% increase	5% decrease	5% increase	5% decrease
Comprehensive income before tax	₩	1,627	(1,627)	5,252	(5,252)

32. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

Interest rate risk
The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of December 31, 2015, there is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation, considering the amounts of interest bearing liabilities.

(ii) Credit risk

The Company has exposure to the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company has transacted with customers with high credit ratings to manage credit risk, and has implemented and operated policies and procedures for credit enhancements of the financial assets. Counterparty credit risk is managed by evaluating its credit rating and limiting the aggregate amount and duration of exposure before sales commence, and the Company has been provided collateral and guarantees. The credit ratings of all counterparties and the level of collateral and guarantees are reviewed regularly. Analysis of financial assets past due has been reported quarterly and appropriate measures have been taken to secure the Company's assets.

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of December 31, 2015 and 2014 is as follows:

In millions of won		2015	2014
Available-for-sale debt instruments	₩	1,500	2,500
Long-term deposits in MSA Escrow Fund		403,966	301,808
Trade and other receivables		1,153,462	945,650
Other financial assets (excluding derivatives)		1,080,000	640,000
Cash and cash equivalents (excluding cash on hand)		441,753	320,679
Financial guarantee contracts		76,566	150,063
	₩	3,157,247	2,360,700

For the years ended December 31, 2015 and 2014

32. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

(iii) Liquidity risk

The Company has exposure to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company's management has established short-term and long-term financial management plans to manage the liquidity risk, and analyzed cash outflows occurred and cash outflows budgeted, so as to match the maturity structure of financial assets and financial liabilities. The Company's management determines whether or not the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets.

The maturity analysis with a residual contractual maturity of financial liabilities as of December 31, 2015 and 2014 is as follows:

				Residual contractual maturity		
In millions of won		Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years
As of December 31, 2015:						
Trade and other payables	₩	252,635	253,343	225,084	19,583	8,676
Short-term borrowings		5,031	5,031	5,031	-	-
Financial guarantee liabilities		-	76,566	-	-	76,566
	₩	257,666	334,940	230,115	19,583	85,242
As of December 31, 2014:						
Trade and other payables	₩	239,346	240,489	211,036	-	29,453
Short-term borrowings		5,552	5,552	5,552	-	-
Financial guarantee liabilities		-	150,063	-	150,063	-
	₩	244,898	396,104	216,588	150,063	29,453

The above financial liabilities are presented at the nominal value of undiscounted future cash flows as of the earliest period at which the Company can be required to pay.

32. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair Value of Financial Instruments

The carrying amounts of each category of financial assets and liabilities as of December 31, 2015 and 2014 are summarized as follows:

In millions of won		2015	2014
Financial assets:			
Financial assets at fair value through profit or loss			
(derivative financial instruments)	₩	11,976	-
Available-for-sale financial assets		340,149	304,438
Loans and receivables			
–Trade and other receivables		1,153,462	945,650
–Long-term deposits in MSA Escrow Fund		403,966	301,808
–Other financial assets (excluding derivatives)		1,080,000	640,000
–Cash and cash equivalents		444,376	321,562
		3,081,804	2,209,020
	₩	3,433,929	2,513,458
Financial liabilities:			
Financial liabilities measured at amortized cost			
–Trade and other payables	₩	252,635	239,346
–Short-term borrowings		5,031	5,552
	₩	257,666	244,898

The fair value measurements classified by fair value hierarchy as of December 31, 2015 and 2014 were as follows:

		Carrying			Fair value
In millions of won		amount	Level I	Level II	Level III
As of December 31, 2015:					
Available-for-sale financial assets	₩	302,594	187,486	-	115,108
Other financial assets					
(derivative financial instruments)		11,976	-	-	11,976
	₩	314,570	187,486	-	127,084
As of December 31, 2014:					
Available-for-sale financial assets	₩	274,844	184,118	-	90,726

There is no transfer between fair value hierarchy levels of recurring fair value measurements for the years ended December 31, 2015 and 2014.

32. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair Value of Financial Instruments, Continued

The fair value measurements for available-for-sale equity instruments in real estate trust fund and derivative financial instruments have been measured using the adjusted net asset method, DCF and option pricing model and categorized as a level 3 fair value based on the inputs to the valuation techniques used. Changes in fair value classified as level 3 for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Beginning balance	₩	90,726	62,467
Acquisition		33,073	38,992
Disposal		-	(14,411)
Changes in fair value		3,285	3,678
Ending balance	₩	127,084	90,726

(e) Finance Income (Costs)

(i) Details of finance income (costs) by categories for the year ended December 31, 2015 were as follows:

In millions of won		Financial assets at fair value through profit or loss	Available -for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:						
Interest income	₩	-	40	33,290	-	33,330
Dividend income		-	12,015	-	-	12,015
Interest income on long-term deposits in MSA Escrow Fund		-	-	1,287	-	1,287
Gain on valuation of derivative financial instruments		1,103	-	-	-	1,103
Gain on sale		-	25,183	-	-	25,183
Interest expense		-	-	-	(793)	(793)
Impairment loss		-	(95)	-	-	(95)
	₩	1,103	37,143	34,577	(793)	72,030
Other comprehensive income (loss) before tax						
Net change in fair value	₩	-	1,744	-	-	1,744
Reclassification adjustments on sale		-	(25,183)	-	-	(25,184)
Reclassification adjustments on impairment		-	95	-	-	95
	₩	-	(23,344)	-	-	(23,345)

32. Risk Management and Fair Value of Financial Instruments, Continued

(e) Finance Income (Costs), Continued

(ii) Details of finance income (costs) by categories for the year ended December 31, 2014 were as follows:

In millions of won		Available -for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:					
Interest income	₩	50	35,555	-	35,605
Dividend income		16,842	-	-	16,842
Investment income on long-term deposits in MSA Escrow Fund		-	877	-	877
Gain on sale		20,132	-	-	20,132
Interest expense		-	-	(830)	(830)
	₩	37,024	36,432	(830)	72,626
Other comprehensive income before tax					
Net change in fair value	₩	(8,712)	-	-	(8,712)
Reclassification adjustments on sale		(20,132)	-	-	(20,132)
	₩	(28,844)	-	-	(28,844)

33. Capital Management

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board of directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

The Company monitors capital using equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same capital management strategy that was applied in the previous year.

As of December 31, 2015 and 2014, the Company's capital structure was as follows:

In millions of won		2015	2014
Debt (borrowings)	₩	5,031	5,552
Less:			
Cash and cash equivalents		(444,376)	(321,562)
Current other financial assets		(1,091,976)	(640,000)
Net debt (asset)		(1,531,321)	(956,010)
Equity	₩	5,896,481	5,341,733

34. Contingent Liabilities and Commitments

(a) Each year the Company deposits a proportion of sales of tobacco products in the United States in accordance with the Tobacco Master Settlement Agreement ("MSA") under the Escrow Statute of the United States government. The MSA Escrow Funds are maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Company 25 years from the date of each annual funding. The Company recorded as long-term deposits the amounts paid into the MSA Escrow Funds of State governments in the United States against potential litigation and damages related to the export of tobacco into the United States.

(b) As of December 31, 2015, the tobacco lawsuits claiming damages of ₩100 million and a lawsuit by National Health Insurance Service claiming damages of ₩53,742 million are filed against the Company. Additionally, as of December 31, 2015, the Company is involved in five lawsuits as a plaintiff for alleged damages totalling ₩14,783 million and six lawsuits as a defendant for alleged damages totalling ₩2,526 million. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2015.

(c) As of December 31, 2015, the Company has entered into letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 59,000 thousand.

(d) As of December 31, 2015, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 20,380 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

(e) The Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 40,000 thousand by Korea Exchange Bank. Details of guarantees exercised as of December 31, 2015, are summarized as follows:

In thousands of USD, THB and millions of IDR		Exercised amount
Customs bond and L/C opening of Global Trading, Inc.	USD	14,222
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB	8,142
Payment guarantee for purchase of certificate stamp of PT Mandiri Maha Mulia	IDR	128,410

(f) On March 17, 2011, the Company signed the memorandum of understanding ("MOU") on global investment partnership with National Pension Service to jointly invest in foreign assets with a limit of ₩800,000 million.

34. Contingent Liabilities and Commitments, Continued

(g) With relation to the acquisition of KT&G Life Sciences Corporation, the Company entered into a contract with a former owner of the acquiree, Gwak, Tae-Hwan ("Individual Shareholder"). Details of the contract are as follows:

Description	Details
Restriction of disposal	Individual Shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after KT&G Life Sciences Corporation is listed.
Right of first refusal held by the Company	Individual Shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless Individual Shareholder has offered them first to the Company.
Tag-along right held by Individual Shareholder	In the event that the Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of its shares, then Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

(h) As of December 31, 2015, the Company has provided guarantees up to ₩225,600 million with an exercised amount of ₩76,566 million for the buyers of apartments in respect of their borrowings from Shinhan Bank.

(i) As of December 31, 2015, the Company is insured by performance bond insurance up to ₩1,157 million with the Seoul Guarantee Insurance.

35. Cash Flows

(a) Details of cash generated from operations for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Profit for the year	₩	987,924	747,054
Adjustments for:			
Income tax expense		331,516	298,400
Finance costs		888	830
Finance income		(81,917)	(77,139)
Depreciation		105,353	104,113
Amortization		24	58
Retirement and termination benefits		47,058	29,676
Foreign currency translations loss		3,317	3,185
Loss on sale of property, plant and equipment		513	1,290
Loss on sale of intangible assets		-	2
Impairment loss on intangible assets		-	2,658
Loss on disposal of investment in associates		370	-
Loss on disposal of investment in subsidiaries		-	5
Impairment loss on investment in subsidiaries		34,601	123,900
Other expense		7,117	4,064
Foreign currency translations gain		(39,761)	(31,247)
Reversal of impairment loss on trade and other receivables		(8,897)	(10,274)
Reversal of write-down of inventory		(183)	(1,911)
Gain on sale of property, plant and equipment		(12,421)	(8,064)
Gain on sale of intangible assets		(723)	-
		1,374,779	1,186,600
Changes in working capital:			
Trade and other receivables		(123,588)	(62,879)
Advance payments		(6,256)	16,395
Prepaid expenses		(1,470)	2,523
Prepaid tobacco excise and other taxes		(186,998)	1,997
Inventories		19,916	59,943
Trade and other payables		69,305	(75,874)
Advance receipts		78	6,933
Tobacco excise and other taxes payable		515,621	(93,525)
Payment of retirement and termination benefits		(60,499)	(39,860)
Cash generated from operations	₩	1,600,888	1,002,253

(b) Details of material transactions without cash inflow and outflow for the years ended December 31, 2015 and 2014 were as follows:

In millions of won		2015	2014
Increase in accrued expenses related to payment of retirement and termination benefits	₩	1,141	-
Acquisition of available-for-sale financial assets upon exercise of conversion options		28,990	-
Decrease in other payables related to acquisition of property, plant and equipment		3,166	-
Decrease in advance receipts related to disposal of property, plant and equipment and non-current assets held for sale		298	-

(c) The Company presented cash flows arising from short-term financial instruments on a net basis.

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Independent Accountants' Review Report on Internal Accounting Control System

English translation of a Report Originally Issued in Korean

To the President of
KT&G Corporation:

We have reviewed the accompanying Report on the Operations of Internal Accounting Control System ("IACS") of KT&G Corporation (the "Company") as of December 31, 2015. The Company's management is responsible for designing and maintaining effective IACS and for its assessment of the effectiveness of IACS. Our responsibility is to review management's assessment and issue a report based on our review. In the accompanying report of management's assessment of IACS, the Company's management stated: "Based on the assessment on the operations of the IACS, the Company's IACS has been effectively designed and is operating as of December 31, 2015, in all material respects, in accordance with the IACS Framework (name of other standard, if used) issued by the Internal Accounting Control System Operation Committee."

We conducted our review in accordance with IACS Review Standards, issued by the Korean Institute of Certified Public Accountants. Those Standards require that we plan and perform the review to obtain assurance of a level less than that of an audit as to whether Report on the Operations of Internal Accounting Control System is free of material misstatement. Our review consists principally of obtaining an understanding of the Company's IACS, inquiries of company personnel about the details of the report, and tracing to related documents we considered necessary in the circumstances. We have not performed an audit and, accordingly, we do not express an audit opinion.

A company's IACS is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, however, IACS may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on our review, nothing has come to our attention that Report on the Operations of Internal Accounting Control System as of December 31, 2015 is not prepared in all material respects, in accordance with IACS Framework issued by the Internal Accounting Control System Operation Committee.

This report applies to the Company's IACS in existence as of December 31, 2015. We did not review the Company's IACS subsequent to December 31, 2015. This report has been prepared for Korean regulatory purposes, pursuant to the External Audit Law, and may not be appropriate for other purposes or for other users.

KPMG Samjong Accounting Corp.

Seoul, Korea
February 25, 2016

Notice to Readers

This report is annexed in relation to the audit of the separate financial statements as of December 31, 2015 and the review of internal accounting control system pursuant to Article 2-3 of the Act on External Audit for Stock Companies of the Republic of Korea.

Report on the Operations of Internal Accounting Control System

English translation of a Report Originally Issued in Korean

To the Board of Directors and Audit Committee of
KT&G Corporation:

I, as the Internal Accounting Control Officer ("IACO") of KT&G Corporation (the "Company"), assessed the status of the design and operations of the Company's internal accounting control system ("IACS") for the year ended December 31, 2015.

The Company's management including the IACO is responsible for the design and operations of its IACS. I, as the IACO, assessed whether the IACS has been effectively designed and is operating to prevent and detect any error or fraud which may cause any misstatement of the financial statements, for the purpose of establishing the reliability of financial reporting and the preparation of financial statements for external purposes. I, as the IACO, applied the IACS Framework for the assessment of design and operations of the IACS.

Based on the assessment of the operations of the IACS, the Company's IACS has been effectively designed and is operating as of December 31, 2015, in all material respects, in accordance with the IACS Framework issued by the Internal Accounting Control System Operation Committee.

January 20, 2016

Kang, Kyeong Bo   Internal Accounting Control Officer

Baek, Bok In   President and Chief Executive Office